The Adequate Protection of Secured Creditors in Termination of Stay Litigation Under the Bankruptcy Code

"Adequate protection" is a doctrine that is used by bankruptcy courts to safeguard secured creditors' rights during bankrutpcy proceedings. One thread of the doctrine is a concept of equity—namely, that a secured creditor should receive the benefit of his bargain.[1] The "benefit" of the secured creditor's bargain is the creditor's right of recourse in the face of a defaulting debtor to the collateral securing the debt.[2] The bankruptcy laws suspend the creditor's right of recourse to collateral as soon as his debtor institutes bankruptcy proceedings. The creditor, however, is entitled to protection from the erosion of the collateral's value for the duration of the proceedings. The bankruptcy court is obligated to provide "adequate protection" of that value. The obligation arises not merely from equitable principles, but from the creditor's basic constitutional right to his interest in property under the fifth amendment.[3] The constitutional guarantee has been interpreted as requiring that the creditor receive at least the "liquidation" or "forced-sale" value of the collateral.[4]

Upon the foundation of constitutional right and equitable principle rests a stautory framework—the Bankruptcy Code[5]—that is designed to provide guidance to the court when it is implementing the equitable doctrine. The general statutory language is applied on a case by case basis by bankruptcy courts in order to fashion appropriate protection for creditors in each case. Bankruptcy courts have the power of a court of equity.[6]

Although adequate protection is guaranteed by the statute and the Constitution, it often is not provided to the creditor as early in the bankruptcy proceeding as he might desire. In order to hasten the court's consideration of his adequate protection, the creditor must initiate an adversary proceeding within the context of the nonadversary bankruptcy case. In that proceeding the secured creditor seeks to convince the court to terminate or modify the suspension of his right of recourse to the collateral in which he has an interest.

The issue of adequate protection has been litigated frequently since

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1. H. R. REP. NO. 595, 95th Cong., 1st Sess. 339 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6295–96, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

2. *See generally* National Bank & Trust Co. of Columbus v. Williams (*In re* Melissa Williams), 7 Bankr. 234, 235–39, 3 COLLIER BANKR. CAS. 2d (MB) 409, 412–17 (Bankr. M. D. Ga. Nov. 25, 1980).

3. Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 278 (1940).

4. *Id.*

5. 11 U.S.C. §§ 101–151326 (Supp. III 1979).

6. 28 U.S.C. § 1481 (Supp. II 1978).

Congress enacted the Bankruptcy Reform Act of 1978.[7] Under the Reform Act there are provisions that the secured creditor may invoke to lessen the actual or potential diminution of the value of his property that may occur because of the passage of time or the use of the property by a debtor who is under the protection of the court. How creditors' rights are suspended by the Bankruptcy Code[8] and how secured creditors obtain protection of their property rights by initiating adversary proceedings during the bankruptcy case will be explored in this Comment.

I. THE COMMENCEMENT OF A BANKRUPTCY CASE: THE AUTOMATIC PROVISIONS

A debtor commences a bankruptcy case by filing a petition[9] under one of the chapters of the Code that provides for relief. Chapter 7,[10] often referred to as "straight bankruptcy,"[11] provides relief to a debtor by the orderly liquidation of his estate and is applicable to both individual and business debtors. The purpose of Chapter 7 is to provide the debtor with a "fresh start" through the discharge of his debts.[12] Conversely, Chapters 9,[13] 11,[14] and 13[15] provide relief to the debtor by rehabilitation, allowing the debtor to retain most of his assets while adjusting his affairs with his creditors under the protection of the court.[16] Although some of the debtor's obligations may be discharged in the course of a rehabilitation proceeding, the object of rehabilitation is for the debtor to emerge as a healthy, intact economic entity.

When the debtor commences his nonadversary proceeding in bankruptcy, he petitions for relief under the appropriate "operative"[17] chapter. The voluntary[18] petition in bankruptcy by which the debtor commences the case constitutes an automatic order for relief by the court under the operative chapter in which the debtor is proceeding.[19]

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7. Pub. L. No. 95-598, 92 Stat. 2549 (1978). See Part III of this Article for a discussion of the adequate protection cases arising under the new Bankruptcy Code, which became effective on October 1, 1979.

8. The Bankruptcy Code, 11 U.S.C. §§ 101-151326 (Supp. III 1979), will hereinafter be referred to as the "Reform Act," the "Code," or the "statute."

9. 11 U.S.C. § 301 (Supp. III 1979).

10. *Id.* §§ 701-766.

11. This term is used to distinguish liquidation from rehabilitation.

12. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. United States Fidelity, 236 U.S. 549, 554-55 (1914)).

13. 11 U.S.C. §§ 901-946 (Supp. III 1979).

14. *Id.* §§ 1101-1174.

15. *Id.* §§ 1301-1330.

16. H. R. REP. NO. 595, 95th Cong., 1st Sess. 220-21 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6179-80, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

17. Chapter 7, 9, 11, or 13.

18. 11 U.S.C. § 301 (Supp. III 1979). Under § 303, an involuntary petition under Chapter 7 or 11 may be filed against a person (defined in § 101(30)), excepting farmers and certain corporations, by three of more entities that meet certain qualifications.

19. 11 U.S.C. § 301 (Supp. III 1979) ("The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter."). *See* 11 U.S.C. § 102(6) (Supp. III 1979).

The order for relief automatically triggers the creation of the debtor's "estate,"[20] which comprises the debtor's property and interests in property, both legal and equitable, acquired before or after the commencement of the case.[21] There are few possessions or interests of the debtor that do not become part of the estate, which becomes an entity distinct from the debtor for the purposes of the Code.

By virtue of the order for relief, the debtor and the estate are automatically protected from many creditor actions by the stay provisions of section 362(a).[22] The stay can best be described as an automatic injunction requiring no positive action by the bankruptcy court. The filing of the petition operates as constructive notice of the stay to all creditors.[23] For example, section 362(a) would suspend or stay the right of a secured creditor to commence proceedings in aid of execution against the estate's property under state law. The policies underlying liquidation and rehabilitation require such a stay so that the bankruptcy case can proceed in an orderly fashion. Also, the policies require that the interests of *all* creditors be safeguarded. The automatic stay effectuates the policies of the bankruptcy laws by performing the function of holding creditors at bay.[24]

The stay enjoins all actions against the debtor or the estate unless excepted by the statute. Specifically, it prohibits the commencement or continuation of any civil suit by a private sector creditor to recover or enforce a claim against the debtor or the property of the estate.[25] Secured creditors are

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20. *Id.* § 541(a).

21. *Id.* § 541(a)(1), (a)(7). See *In re* Paukner, 10 Bankr. 29, 34 (Bankr. N.D. Ohio Jan. 9, 1981), in which the court declined to follow those cases that include "in the estate all property in which the debtor has any interest," because "[s]ection 541 includes in the estate all interests which the debtor has in property; this is not the same as all property in which the debtor has any interest." (Quoting Parker GMC Truck Sales, Inc. v. United States (*In re* Parker GMC Truck Sales, Inc.), 2 COLLIER BANKR. CAS. 2d (MB) 1142, 1145 (Bankr. S.D. Ind. Aug. 25, 1980)).

22. 11 U.S.C. § 362(a) provides:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

23. *See In re* Reed, 11 Bankr. 258, 275, 4 COLLIER BANKR. CAS. 2d (MB) 736, 755 (Bankr. D. Utah May 15, 1981).

24. *See* note 16 *supra*.

25. 11 U.S.C. § 362(a)(1).

forbidden to "create, perfect, or enforce" any lien against property of the estate to the extent that such a lien "secures a claim arising before the commencement of the case."[26] The stay also forbids action to obtain possession of property from the estate.[27] For example, upon the filing of the petition, a foreclosure action on a mortgage deed in state court would be stayed. An action in replevin in state court or a self-help attempt to repossess an automobile would be forbidden. Because the stay is a court order, any act in violation of the stay is in contempt of court.[28]

Because the stay is automatic, the timing of the petition can be very important to the debtor. In one case a debtor filed its petition two hours before the sheriff was to evict the debtor from its place of business. The automatic stay stopped the eviction.[29] In another, the debtor filed her petition thirty minutes after a foreclosure sale. The debtor's attorney argued that "date of filing" in section 541(a)(5) (the section that creates the bankruptcy estate and to which section 362(a) implicitly refers) referred to the entire twenty-four hour period of the day of the petition. Under this argument a petition filed at any time during the day of a sale would invoke properly the automatic stay provisions to void the sale. The court, however, ruled that "date of filing" referred to the time of day that the petition was filed and allowed the sale to stand.[30]

The automatic provisions of the Code evince a policy on the part of Congress to protect debtors from their pursuing creditors.[31] The automatic order for relief on the filing of the petition coupled with the automatic stay provide the debtor protection during bankruptcy proceedings under any of the operative chapters of the Code.[32] Counterbalancing the provisions protecting debtors are provisions designed to determine and protect the secured status of the creditor during the proceedings.

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26. *Id.* § 362(a)(5).

27. *Id.* § 362(a)(3).

28. *In re* Eisenberg, 7 Bankr. 683, 686–91, 3 COLLIER BANKR. CAS. 2d (MB) 440, 447–53 (Bankr. E.D.N.Y. Dec. 10, 1980) (If after actual notice, a lien creditor defies the automatic stay, the fact of his defiance will be certified to the district court and criminal contempt proceedings recommended. Rule 920 of the Federal Rules of Bankruptcy Procedure, insofar as it places a limit on a bankruptcy court's contempt power, is inconsistent with the interim power granted by 28 U.S.C. § 1481 (Supp. III 1979), and therefore is a nullity.). *See also* Asters v. Webber Chevrolet Co. (*In re* Asters), 11 Bankr. 483, 485, 4 COLLIER BANKR. CAS. 2d (MB) 707, 710 (Bankr. D.R.I. June 4, 1981) (creditor, held in contempt, ordered to pay compensatory and punitive damages to debtor for violating automatic stay); *In re* Reed, 11 Bankr. 258, 275, 4 COLLIER BANKR. CAS. 2d (MB) 736, 755 (Bankr. D. Utah May 15, 1981) (only constructive notice required for finding civil contempt for violation of the stay).

29. Grand Hudson Corp. v. GSVC Restaurant Corp. (*In re* GSVC Restaurant Corp.), 3 Bankr. 491, 494, 1 COLLIER BANKR. CAS. 2d (MB) 727, 730 (Bankr. S.D.N.Y. Apr. 3, 1980), *aff'd*, 10 Bankr. 300 (S.D.N.Y. 1980).

30. Holloway v. Kleitz (*In re* Kleitz), 6 Bankr. 214, 216–17, 218, 2 COLLIER BANKR. CAS. 2d (MB) 332, 334–35, 337 (Bankr. D. Nev. May 16, 1980).

31. S. REP. NO. 989, 95th Cong., 2d Sess. 50 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5836, *and in* 16 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 52 (1979).

32. *See* note 17 and accompanying text *supra*.

II. The Determination and Protection of Secured Claims Under the Code

Unless otherwise provided in the "relief" or "operative" chapters of the Code,[33] Chapters 1, 3, and 5 are of general applicability.[34] Chapter 1[35] consists of general provisions, such as definitions,[36] rules of construction,[37] and rules for extensions of time.[38] Chapter 3[39] is devoted to case administration: commencement of the case,[40] appointment and removal of trustees and other officers,[41] other administrative matters, meetings of creditors,[42] and relief from the stay.[43] Part III of this Comment will focus on Chapter 3.[44] Chapter 5[45] deals with creditors and claims,[46] debtor's duties and benefits,[47] and the estate.[48] Chapter 5 contains most of the provisions with which a secured creditor is initially concerned. It is important first to identify what might be meant by "secured creditor" for purposes of the Code.

The term "secured creditor" is neither used nor defined by the Code. Instead, the Reform Act speaks of a "secured claim."[49] Encumbrances on property are defined in terms of "liens." "Lien" is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation."[50] The Code refers to holders of such interests in property generally as "lien creditors." Since the statute uses the term "secured claim" to refer to the claims of the general lien creditor,[51] the term "secured creditor" has no meaningful equivalent under the Code. The Reform Act does recognize three different types of liens: judicial liens,[52] statutory liens,[53] and security interests.[54] A judicial lien is a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."[55] A statutory lien arises solely by force of statute and excludes both judicial liens and

33. *Id.*
34. 11 U.S.C. § 103(a) (Supp. III 1979).
35. *Id.* §§ 101–109.
36. *Id.* § 101.
37. *Id.* § 102.
38. *Id.* § 108.
39. *Id.* §§ 301–366.
40. *Id.* §§ 301–306.
41. *Id.* §§ 321–331.
42. *Id.* §§ 341–350.
43. *Id.* § 362.
44. *See* text accompanying notes 84–181 *infra*.
45. 11 U.S.C. §§ 501–554 (Supp. III 1979).
46. *Id.* §§ 501–510.
47. *Id.* §§ 521–525.
48. *Id.* §§ 541–554.
49. *Id.* § 506(a).
50. *Id.* § 101(28).
51. *Cf. id.* § 544(a) (trustee as lien creditor).
52. 11 U.S.C. § 101(27) (Supp. III 1979).
53. *Id.* § 101(38).
54. *Id.* § 101(37).
55. *Id.* § 101(27).

security interests.[56] Finally, a security interest is a lien created by agreement between debtor and creditor.[57] *All* liens created by agreement, including real property mortgages, are security interests under the Reform Act.[58] Because of the ability of the trustee to avoid judicial liens[59] and statutory liens,[60] most termination of stay litigation initiated by lien creditors involves creditors holding security interests, *i.e.*, liens created by agreement; for convenience, "secured creditor," as used in this Comment, will denote only those creditors holding security interests in property of the estate.

To protect his security interest, a creditor may file with the court a "proof of claim," a document setting forth his claim.[61] A secured creditor is not required to file the proof of claim, but it may be advantageous to do so, especially when the creditor's claim is misstated on the debtor's schedule of liabilities[62] or when the creditor also has an unsecured claim. The proof of claim is prima facie evidence of the validity and amount of the claim.[63] If the secured creditor files a claim, he must designate it as secured and attach evidence of the obligation and proof of the perfection of the security interest.[64] For example, a mortgagee would indicate the amount outstanding on the mortgage loan and attach the note and the recorded mortgage deed to the proof of claim. A creditor with a nonpurchase money security interest in goods of the debtor[65] would attach the note and financing statement.[66] A creditor with a purchase money security interest[67] in consumer goods[68] would attach some evidence of the purchase of the goods, such as a charge account invoice and a signed security agreement.[69]

If a proof of claim is filed by the creditor, the claim is deemed allowed unless a party in interest objects.[70] If an objection is made, the court will determine after notice and a hearing to what extent, if any, the claim will be allowed.[71] In addition, the court will determine the secured status of the claim.[72] An allowed claim of a creditor secured by a lien on property is a secured claim "to the extent of the value of such creditor's interest in the *estate's* interest in such property."[73] If the creditor is undersecured, his claim

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56. *Id.* § 101(38).
57. *Id.* § 101(37).
58. S. REP. NO. 989, 95th Cong., 2d Sess. 26 (1978), *reprinted in* 1978 U.S. CODE CONG.& AD. NEWS 5787, 5811–12, *and in* 16 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 52 (1979).
59. 11 U.S.C. § 544(a)(1) (Supp. III 1979).
60. *Id.* § 545 (Supp. III 1979). *See generally* Schneyer, *Statutory Liens Under the New Bankruptcy Code—Some Problems Remain*, 55 AM. BANKR. L.J. 1 (1981).
61. 11 U.S.C. § 501 (Supp. III 1979).
62. *See, e.g., id.* § 1111.
63. FED. R. BANKR. P. 301(b).
64. *Id.* 302(c).
65. *See* U.C.C. § 9–107 (1972) (definition of purchase money security interest).
66. FED. R. BANKR. P. 302(c). *See generally* U.C.C. § 9–302 (1972).
67. U.C.C. § 9–107 comment 2 (1972).
68. U.C.C. § 9–109(1) (1972); *cf.* 11 U.S.C. § 101(7) (Supp. III 1979) (definition of consumer debt).
69. FED. R. BANKR. P. 302(c). *See* U.C.C. § 9–203(1) (1972); *see also id.* § 9–302(1)(d).
70. 11 U.S.C. § 502(a) (Supp. III 1979).
71. *Id.* § 502(b).
72. *Id.* § 506(a).
73. *Id.* (emphasis added).

is unsecured to the extent of the excess of the claim over the value of the collateral.[74] It is within the court's discretion to place a value on the collateral.[75] This valuation by the court becomes important in termination of stay litigation.[76]

One potential problem for a secured creditor is that the debtor or the trustee may avoid any nonpossessory, nonpurchase money security interest to the extent that the interest encroaches on the debtor's exemptions under section 522.[77] For example, if AAA Finance Company extends a personal loan for 500 dollars to *B*, who signs a security agreement[78] covering *B*'s household goods, which are exempted property, *B* may avoid that security interest to the extent of 200 dollars in the event of his bankruptcy.[79]

In summary, when a creditor files a proper proof of claim,[80] or his claim is properly listed on the debtor's schedule of liabilities, it is an allowed claim unless a party in interest objects.[81] The creditor's allowed claim is secured to the extent of the value of the collateral and unsecured in the amount by which he is undersecured.[82] A creditor also must consider the debtor's exemptions when he holds a nonpurchase money security interest.[83]

Although the bankruptcy court is constitutionally required to guarantee to the creditor a minimum of the forced-sale or liquidation value of the collateral in the course of the bankruptcy proceedings, a creditor may desire adequate protection earlier in the case than would normally be provided under the Code. The commencement of the bankruptcy case, the creation of the estate, the operation of the automatic stay, and the proof and allowance of the secured creditor's claim have been considered thus far. When a creditor fears erosion of his secured position through the depreciation or the use and consumption of the collateral by the debtor, he may seek relief from the stay by initiating an adversary proceeding to terminate the stay.

III. Adequate Protection and Relief from the Stay

A creditor desiring adequate protection early in the bankruptcy case will find potential relief under section 362(d)(1).[84] That section provides that the

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74. *Id.*
75. *Id.*
76. *See* text accompanying notes 168–77 *infra*.
77. 11 U.S.C. § 522(f) (Supp. III 1979).
78. *See* U.C.C. § 9–203 (1977).
79. 11 U.S.C. § 522(d)(3) (Supp. III 1979).
80. *See* text accompanying notes 61–70 *supra*.
81. *See* text accompanying notes 70–76 *supra*.
82. *See* text accompanying notes 72–76 *supra*.
83. *See* text accompanying notes 77–79 *supra*.
84. 11 U.S.C. § 362(d)(1) (Supp. III 1979) provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest. . . .

court *shall* grant relief from the stay "for cause."[85] The statute cites only one such cause for relief—lack of adequate protection. Other causes for relief from the stay can be raised by a party in interest, however. The legislative history of the Reform Act indicates that a cause, such as the lack of any connection between a case in state court and the pending bankruptcy case, is sufficient to grant relief from the stay.[86] For example, a divorce or child custody proceeding involving the debtor or a probate proceeding in which the debtor is the executor of an estate is generally unrelated and should not be stayed.[87] The court in *Pagitt v. Pagitt*,[88] however, found divorce proceedings initiated in two different states by husband and wife to be sufficiently related to the property of the estate and the debtor-wife's rehabilitation to order the stay continued.[89] Whether a tangential proceeding is sufficiently related to justify continuation of the stay by the court depends on the particular circumstances of each case.[90]

A party in interest requests relief from the stay in the form of a "Complaint to Modify (or Terminate) the Stay" filed with the court.[91]

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85. *Id.* Another basis for obtaining relief from the stay is in § 362(d)(2): "with respect to a stay of an act against property, if—(A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization." Subsection 2 is presented as an alternative to subsection 1 by the use of the disjunctive "or" between them. Under the old Act, courts such as the Third Circuit presented four considerations in lifting the stay, which included the prospect or likelihood of a successful debtor reorganization. *See* Industrial Nat'l Mortgage Co. v. Union Deposit Center Equities Ltd. Partnership, 639 F.2d 1045, 1048 (3d Cir. 1981) (Chapter XII (old Act)); *In re* Roloff, 598 F.2d 783 (3d Cir. 1979); *see also* Peitzman and Smith, *The Secured Creditor's Complaint: Relief From the Automatic Stays in Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216, 1225–33 (1977). Under the new Code, the issue of adequate protection alone is a sufficient basis for granting relief from the stay. Citizens Fidelity Bank & Trust Co. v. Family Invs., Inc. (*In re* Family Invs., Inc.), 8 Bankr. 572, 575, 7 BANKR. CT. DEC. (CRR) 194, 196 (Bankr. W.D. Ky. Jan. 29, 1981). One of the considerations may be the lack of equity of the debtor. A court may lift the stay for lack of adequate protection *even if* the property is necessary to an effective reorganization. Lincoln Bank v. High Sky, Inc. (*In re* High Sky, Inc.), 15 Bankr. 332, 334–35, 338, 4 COLLIER BANKR. CAS. 2d (MB) 1290, 1293, 1297 (Bankr. M.D. Pa. Aug. 4, 1981) (although court concluded property necessary to effective reorganization, stay lifted on a finding of lack of adequate protection). *But see* Midlantic Nat'l Bank v. Anchorage Boat Sales, Inc. (*In re* Anchorage Boat Sales, Inc.), 4 Bankr. 635, 641–42, 2 COLLIER BANKR. CAS. 2d (MB) 348, 357 (Bankr. E.D.N.Y. June 16, 1980) (court must consider all four "Third Circuit" factors). *Anchorage Boat Sales*' holding that the undersecured creditor was entitled to relief from the stay because of the loss of the use of its money was criticized in *In re* American Mariner Indus., Inc., 10 Bankr. 711, 712, 4 COLLIER BANKR. CAS. 2d (MB) 642, 643 (Bankr. C.D. Cal. Apr. 23, 1981).

86. S. REP. NO. 989, 95th Cong., 2d Sess. 52 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5838, *and in* 16 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 52 (1979). The failure of the debtor to make contractually required periodic payments is another "cause." Federal Nat'l Mortgage Ass'n v. Pelzer (*In re* Pelzer), 15 Bankr. 73, 75, 5 COLLIER BANKR. CAS. 2d (MB) 579, 582 (Bankr. E.D. Pa. Oct. 16, 1981).

87. H. R. REP. NO. 595, 95th Cong., 1st Sess. 343 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6299–300, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

88. (*In re* Pagitt), 3 Bankr. 588, 1 COLLIER BANKR. CAS. 2d (MB) 1013 (Bankr. W.D. La. Apr. 15, 1980). In Family Sav. & Loan Ass'n v. Calabria (*In re* Calabria), 5 Bankr. 73, 2 COLLIER BANKR. CAS. 2d (MB) 113 (Bankr. D. Conn. June 3 1980), the debtor removed a foreclosure action commenced in state court to the bankruptcy court without filing a petition. The court remanded the foreclosure action but retained jurisdiction over issues of homestead exemptions and avoidance of judicial liens. *Id.* at 74, 75, 2 COLLIER BANKR. CAS. 2d (MB) at 115, 116.

89. 3 Bankr. 588, 590, 1 COLLIER BANKR. CAS. 2d (MB) 1013, 1016 (Bankr. W.D. La. Apr. 15, 1980).

90. *Id.*

91. FED. R. BANKR. P. 401(d). Certain problems have arisen because of the Bankruptcy Rules' requirement that a prayer for relief from the stay be presented in a complaint. In filing its answer, the debtor presents defenses. Certain courts and commentators have said that the defenses should be weighed in lifting the stay, but

Summons is issued as in a civil action.[92] The hearing on the complaint is considered an adversary proceeding within the context of the nonadversary bankruptcy case.[93] The procedural mandates for the hearing on the complaint are contained in section 362(e)-(g).[94] Section 362(e) provides that the stay will be terminated with respect to the party requesting relief within thirty days *unless* after notice and hearing the court orders the stay continued.[95] The service of summons on the debtor or his attorney commences the thirty-day period.[96] This provision for a hearing within thirty days can provide rapid relief from the stay for a creditor whose foreclosure sale was halted by the debtor's petition.

Section 362(e) clearly suggests that the stay may be lifted automatically unless there is a hearing within thirty days on the complaint. In an early case

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not considered on their merits in the summary hearing. For a thorough discussion of the complaint and a proposal for framing a request for a stay in a motion, see Peitzman and Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216 (1977). The Peitzman and Smith article was published before the Code was enacted, but took into account drafts of it. The analysis of the creditor's proof is no longer accurate. *See* note 90 *supra*.

The Judicial Conference Advisory Committee on Bankruptcy Rules has promulgated a Preliminary Draft of Proposed New Bankruptcy Rules and Official Forms, dated March 1982. 16 Bankr. Adv. Sh. 27 (Yellow Pages March 1982). It appears that the Conference members have adopted the Peitzman and Smith proposal to frame the request in a motion. PROP. FED. R. BANKR. P. 4001(a). Proposed rule 4001(a) (Relief From the Automatic Stay) refers to proposed rule 9014 (Contested Matters) which provides that relief in such matters shall be requested by motion and that no response is required to the motion unless ordered by the court. Although providing for motion practice, proposed rule 9014 incorporates rule 7004 (Process, Service of Summons; Complaint) and the discovery rules of proposed rules 7026 and 7028–7037, which make the Federal Rules of Civil Procedure applicable, but excludes the pleading rules, counterclaim and cross-claim, third-party practice, and other proposed rules incorporating the Federal Rules of Civil Procedure. Thus, although the Advisory Committee Notes to proposed rule 4001 state that "[s]ubdivision (a) transforms what was an adversary proceeding under the former rules to motion practice," 16 Bankr. Adv. Sh. 27, 113 (Yellow Pages March 1982) (emphasis omitted), the proposed practice retains some aspects of the former adversary proceeding. *See also* PROP. FED. R. BANKR. P. 9013 (Motion; Form and Service), 16 Bankr. Adv. Sh. 27, 172 (Yellow Pages March 1982). The comment period for the proposed rules ended on August 1, 1982.

92. FED. R. BANKR. P. 704; *see* PROP. FED. R. BANKR. P. 4001, 9014, 16 Bankr. Adv. Sh. 27, 112, 172 (Yellow Pages March 1982); *see also* note 91 *supra*.

93. FED. R. BANKR. P. 703; *see* note 91 *supra*.

94. 11 U.S.C. § 362(e)-(g) (Supp. III 1979) provides:

> (e) Thirty days after a request under subsection (d) of this section for relief from the stay of any act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. If the hearing under this subsection is a preliminary hearing—
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> (1) the court shall order such stay so continued if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the final hearing under subsection (d) of this section; and
>
> (2) such final hearing shall be commenced within thirty days after such preliminary hearing.
>
> (f)The court, without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) and (e) of this section.
>
> (g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—
>
> (1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and
>
> (2) the party opposing such relief has the burden of proof on all other issues.

95. *Id.* § 362(e).

96. *Id.*; FED. R. BANKR. P. 703, 704.

under the Reform Act, *In re Feimster*,[97] the court had not scheduled a hearing within the thirty-day period, which technically terminated the stay under 362(a). In a hearing subsequent to the termination of the stay, the court relied upon the general equitable powers of the bankruptcy court to reinstitute the stay. In support of the new stay, the court stated:

> It seems improbable that Congress expected court procedure to allow the automatic stay to routinely terminate after the filing of a § 362(e) complaint before the commencement of a regularly scheduled preliminary hearing.
>
> . . . .
>
> The automatic stay of § 362(a) is merely recognition of the necessity for protection of the estate. . . . Equity and justice may in some situations require a second stay to protect the estate from unwarranted recovery of property or other actions by a creditor.[98]

The above-quoted language does not mean that the stay would be reinstituted in all cases. The court was careful to point out that there had been no alteration in the positions of the parties and that the creditor would be adequately protected.

The view of the *Feimster* court is consistent with the legislative history of the Reform Act. The thirty-day requirement was intended to hasten case administration, which had become very slow under the old Act.[99] There is no indication that the court is forbidden to use its equity powers to protect the estate as clearly intended by the Code.

The hearing within thirty days under section 362(e) is generally a preliminary hearing on the complaint. The standard by which the court judges whether to continue the stay is "a reasonable likelihood that the party opposing relief from such stay will prevail at the final hearing."[100] The final hearing on the complaint must be held within thirty days after the preliminary hearing.[101] Often, the preliminary hearing will be consolidated with the final hearing by agreement of the parties. If the creditor files the complaint quickly, the final or consolidated hearing will occur before the normal hearing on the confirmation of the debtor's plan in a rehabilitation proceeding. The procedure itself, if used properly, provides an early hearing.[102]

A method of *ex parte* relief is available to creditors under section 362(f).[103] If the creditor can convince the court that relief from the stay is necessary to "prevent irreparable damage to [his] interest" in property of the

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97. Citizens & S. Nat'l Bank v. Feimster, 3 Banker 11, 1 COLLIER BANKR. CAS. 2d (MB) 956 (Bankr. N.D. Ga. Nov. 21, 1979).

98. *Id.* at 12–13, 1 COLLIER BANKR. CAS. 2d (MB) at 957–58. *See also* International Harvester v. Kleinsasser (*In re* Kleinsasser), 12 Bankr. 452, 454, 4 COLLIER BANKR. CAS. 2d (MB) 1185, 1188 (Bankr. D.S.D. July 7, 1981) (court relies on general principles expressed in § 105 of the Code in reinstating the stay).

99. Kennedy, *Automatic Stays Under the New Bankruptcy Code* (pt. 2), 12 U. MICH. J.L. REF. 1, 41 (1978).

100. 11 U.S.C. § 362(e)(1) (Supp. III 1979).

101. *Id.* § 362(e)(2).

102. *See* text accompanying notes 118–24 *infra*.

103. 11 U.S.C. § 362(f) (Supp. III 1979).

estate before the opportunity for a hearing,[104] then such relief will be granted. It has been suggested that this provision is an extraordinary remedy by its own terms that should be used only in exceptional circumstances.[105] Few creditors have requested such relief in reported cases under the Reform Act; creditors who have obtained relief alleging irreparable harm have often been granted relief on other grounds after a hearing.[106] Because of the provisions for an early hearing under section 362(e), it is most likely unnecessary for the court to consider *ex parte* relief in the majority of cases.

The majority of cases in which relief from the stay is requested are rehabilitation proceedings. By way of contrast, because one of the goals of liquidation proceedings is the orderly and expeditious dismemberment of the estate, creditors have better prospects of obtaining possession of their collateral without resort to adversary proceedings. Since in many instances creditors will receive only the liquidation value of the collateral on its sale, they have little to protect unless the depreciation is eroding the value so quickly that no choice is provided other than the initiation of adversary proceedings.

The duties of a trustee in a liquidation proceeding indicate the purposes and operation of Chapter 7. Those duties[107] are to "collect and reduce to money the property of the estate"[108] and close up the estate expeditiously. Other duties include: investigation of the financial affairs of the debtor,[109] examination of proofs of claims, and objection to allowance of improper claims.[110]

If the debtor is engaged in business before filing a petition in Chapter 7, the operation of the business generally ceases so that the trustee can discharge his duties.[111] The trustee may be authorized by the court to operate the business for a limited period, but only if such operation is consistent with the orderly liquidation of the estate.[112]

The liquidation proceeding, then, is a winding up of the debtor's affairs so that creditors may be paid their pro rata share to the extent that the unencumbered assets of the estate allow.[113] The trustee takes title to encumbered

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104. *Id.*

105. Peitzman and Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216, 1258 (1977).

106. Grand Hudson Corp. v. GSVC Restaurant Corp. (*In re* GSVC Restaurant Corp.), 3 Bankr. 491, 494-95, 1 COLLIER BANKR. CAS. 2d (MB) 727, 731 (Bankr. S.D.N.Y. Apr. 3, 1980), *aff'd*, 10 Bankr. 300 (S.D.N.Y. 1980) (creditor claiming irreparable injury granted relief to follow through with eviction because of the "baseless delaying tactics employed by debtor in this case" and the inability of the debtor to provide adequate protection).

107. 11 U.S.C. § 704 (Supp. III 1979).

108. *Id.* § 704(1).

109. *Id.* § 704(3).

110. *Id.* § 704(4).

111. *Cf. id.* § 704(7) ("if the business of the debtor is authorized to be operated. . .").

112. 11 U.S.C. § 721 (Supp. III 1979).

113. *Id.* § 726.

assets subject to the security interests. On distribution, creditors with security interests have priority over all other creditors.[114]

In contrast to liquidation proceedings, the purpose of rehabilitation proceedings is to preserve the business or affairs of the debtor as a going concern with a view to the debtor's emergence after the proceedings as an intact economic entity. Assets may be shed during the proceedings,[115] but the object is the consolidation rather than dismemberment of the debtor. The creditor thus has a much longer period to wait for possession of collateral. Rehabilitation may be advantageous for the creditor, because if it succeeds, the creditor will benefit by receiving a substantial portion, if not all, of the orginal debt instead of the forced-sale value of his collateral.[116] If the debtor has defaulted on a secured obligation before filing his petition, the creditor may be quite concerned about the erosion of his position due to the accrual of interest on his claim[117] or depreciation of the collateral. Termination of stay litigation is more likely to occur under these conditions.

Rehabilitation in Chapters 11 and 13 is officially commenced by the debtor's[118] submission of a plan for payment of his creditors[119] to the court.[120] The Chapter 11 debtor, for example, is allowed a minimum of 120 days from the time of filing the petition in which to submit a plan.[121] Creditors are afforded a certain amount of protection by the confirmation proceedings, because the plan is to provide for the payment of the debtor's obligations.[122] In many cases debtors continue operating their business and remain in possession of collateral securing their obligations for the duration of the plan, which can be many months.[123]

If a secured creditor finds the potential four-month waiting period for the plan unpalatable, he may file his complaint and appear at the hearing on the complaint under section 362(e). The burden of proof of the respective parties is allocated by section 362(g).[124] The party opposing relief from the stay has the burden of proof on all issues except that of the debtor's equity in the property.[125] The creditor has the burden of proving that the debtor has no equity in the collateral. But the debtor must prove that he can provide ad-

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114. *Id.* §§ 726(a)(1) & 507(b).

115. *See, e.g., id.* § 365.

116. *See* H. R. REP. NO. 595, 95th Cong., 1st Sess. 220–21 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6179–80, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

117. Terra Mar Dev. Corp. v. Terra Mar Assocs. (*In re* Terra Mar Assocs.), 3 Bankr. 462, 1 COLLIER BANKR. CAS. 2D (MB) 892 (Bankr. D. Conn. Mar. 31, 1980).

118. *See* 11 U.S.C. §§ 1121(c) (Supp. III 1979) (persons other than debtor may file Chapter 11 plan); *id.* § 1321 (debtor has exclusive right to file a Chapter 13 plan).

119. *See id.* §§ 1123(a), 1322 (contents of plan).

120. *See id.* §§ 1129, 1325 (requirements for court's confirmation of plan).

121. *See id.* § 1121(b) (no creditor may submit plan until 120 day period expired).

122. *See* note 119 *supra.*

123. 11 U.S.C. § 1129 (Supp. III 1979) (a perusal of the "Contents of Plan" section bears out the potential length of the payment plan).

124. *Id.* § 362(g).

125. *Id.* § 362(g)(2).

equate protection to the creditor in order for the stay to continue. In so doing, the debtor must provide concrete proposals for protection of the creditor's interest.[126] The burden of proof allocated in section 362(g) is therefore tantamount to requiring the debtor to submit a "plan" at this early stage.

The Code enumerates three nonexclusive methods by which a debtor can provide adequate protection to the creditor for the duration of the rehabilitation. By proposing one or more of the methods in section 361,[127] a debtor can remain in possession of his property and have some prospect for a successful reorganization.

Section 361(1) allows the debtor to propose periodic cash payments[128] to protect the creditor from a decline in the value of the property because of depreciation or from an erosion of the creditor's position because of the diminution of the debtor's equity "cushion" in the property through the accrual of interest. Periodic cash payments are much like the installment payments that the debtor should be making on the loan, except that the debtor is only obligated to protect the creditor's property interest in the collateral to the extent of his allowed secured claim.[129] Thus, the court in *In re Feimster*[130] ruled that although the debtor owed $24,000 on a recreational vehicle with a fair market value of $12,000 on the date of the petition, the creditor was adequately protected because the periodic cash payments proposed by the debtor were more than sufficient to compensate the creditor for any further depreciation of the vehicle that might occur.[131]

In *Vlahos v. Pitts*,[132] on the other hand, adequate protection of the creditor required preservation of the Chapter 13 debtor's equity cushion in his

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126. The burden of showing adequate protection is clearly on the debtor. It is he who must propose the methods. Provident Sav. & Loan Ass'n v. Pannell (*In re* Pannell), 12 Bankr. 51, 54, 4 COLLIER BANKR. CAS. 2d (MB) 866, 870 (Bankr. E.D. Pa. June 15, 1981). *See also* Calistri v. Barrows (*In re* Barrows), 15 Bankr. 338, 341, 4 COLLIER BANKR. CAS. 2d (MB) 1457, 1460 (Bankr. M.D. Pa. Aug. 13, 1981) (court must consider "balance of hurt").

127. 11 U.S.C. § 361 provides:

> When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

128. *Id.*

129. *See* Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935); *see also* H.R. REP. NO. 595, 95th Cong., 1st Sess. 339 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6295–96, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

130. Citizens & S. Nat'l Bank v. Feimster, 3 Bankr. 11, 1 COLLIER BANKR. CAS. 2d (MB) 956 (Bankr. N.D. Ga. Nov. 21, 1979).

131. *Id.* at 15, 1 COLLIER BANKR. CAS. 2d (MB) at 961. *See also* Chrysler Credit Corp. v. Rider (*In re* Rider), 3 COLLIER BANKR. CAS. 2d (MB) 16, 19 (Bankr. D. Hawaii Oct. 2, 1980) (payments to creditor required between the time of petition and confirmation of the plan).

132. (*In re* Pitts), 2 Bankr. 476, 1 COLLIER BANKR. CAS. 2d (MB) 241 (Bankr. C.D. Cal. Dec. 21, 1979).

personal residence. The court valued the residence at $125,000; the amount outstanding on the loan was $105,875; the equity cushion was therefore $19,125. The court observed that this was minimal protection for the creditor. In so doing, the court noted the debtor's assertion that adequate protection is fully provided by the cushion until eliminated by depreciation of the collateral or an increase in the creditor's claim through the accrual of interest. The court implied that periodic cash payments would be appropriate to prevent the erosion of the creditor's position through the accrual of interest by stating that it would provide "a periodic and careful surveillance of the facts and circumstances and the structuring of relief calculated to avoid dissipation of whatever protection the cushion affords."[133]

Feimster[134] and *Pitts*[135] demonstrate that the focus of the court should be the preservation of the collateral-debt ratio, which is the value of the collateral divided by the amount of the debt.[136] Periodic cash payments are particularly well suited for this purpose in cases of an equity cushion, *i.e.*, a ratio of greater than one, as well as those of a negative equity position—the ratio of less than one. As long as the value of real property, for example, is stable or rising, periodic cash payments in the amount of the accruing interest only should adequately protect the creditor. In the case of personal property periodic payments in the amount of a fixed rate of depreciation should be sufficient.[137]

Another method of protection enumerated in section 361[138] is the allowance of so much compensation as will result in the realization by the creditor of the "indubitable equivalent" of his interest in the property.[139] This compensation is charged against the estate as an administrative expense. The "indubitable equivalent" standard is derived from the principle that a creditor should receive the benefit of his bargain.[140] The standard was created by Learned Hand in *In re Murel Holding Corp.*:[141]

> The last is not, properly speaking, a "method" at all; it merely gives power generally to the judge "equitably and fairly" to "provide such protection," that is, "adequate protection," when the other methods are not chosen. . . . In construing so vague a grant, we are to remember . . . the constitutional limitations to which it must conform. It is plain that "adequate protection" must be completely

133. *Id.* at 478, 1 COLLIER BANKR. CAS. 2d (MB) at 244.

134. 3 Bankr. 11, 1 COLLIER BANKR. CAS. 2d (MB) 956 (Bankr. N.D. Ga. Nov. 21, 1979).

135. 2 Bankr. 476, 1 COLLIER BANKR. CAS. 2d (MB) 241 (Bankr. C.D. Cal. Dec. 21, 1979).

136. Gordanier, *The Indubitable Equivalent of Reclamation: Adequate Protection for Secured Creditors Under the Bankruptcy Code*, 54 AM. BANKR. L.J. 299, 307 (1980).

137. Massari, *Adequate Protection Under the Bankruptcy Reform Act*, 1979 ANN. SURV. BANKR. L. 171, 179. *See* Commercial Trading Co. v. Penn York Mfg., Inc. (*In re* Penn York Mfg., Inc.), 4 COLLIER BANKR. CAS. 2d (MB) 965, 968 (Bankr. M.D. Pa. June 15, 1981) (when there is no equity cushion, interest payments alone insufficient for adequate protection of the creditor).

138. 11 U.S.C. § 361(3) (Supp. III 1979).

139. *Id.*

140. H.R. REP. NO. 595 Cong., 1st Sess. 339 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6295–96, *and in* 13 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 42 (1979).

141. 75 F.2d 941 (2d Cir. 1935).

> compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least his property. We see no reason to . . . deprive him of that . . . unless by a substitute of the most indubitable equivalence.[142]

As indicated by the quoted material, Judge Hand was deciding an extreme case of creditor deprivation. Unfortunately, the two phrases, "completely compensatory" and "most indubitable equivalence," are deceptively far-reaching when taken out of context. Under the Code, the standard of "indubitable equivalent" has been used just as Judge Hand suggests—as a last resort. It is most often used to evaluate the entirety of the debtor's proposed protection to the creditor. For example, in *In re Paradise Boat Leasing Corp.*[143] the debtor was engaged in the business of chartering a boat that was also collateral for a loan. The bankruptcy court invoked the "indubitable equivalent" standard to assess the debtor's ability to provide adequate protection to the creditor. The court observed that the boat was not properly insured against the negligence of a lessee and that the business of leasing boats was a perilous one in which a creditor could lose uninsured collateral at any time. The debtor had proposed no periodic cash payments and could not provide an additional or replacement lien under section 361(2)[144] since the boat was its only asset. The court lifted the stay, finding that the debtor could not provide the "indubitable equivalent" of the creditor's interest in the boat; therefore, the creditor was not adequately protected.[145]

In applying the "indubitable equivalent" standard, the court stated:

> Under this language of the Code, even if the Debtor needs the security property for reorganization he may not use it unless there is no doubt that what the secured creditor is to get, is equal in all particulars to rights the creditor may have to surrender. [The Debtor] has not come near meeting this test.[146]

In considering Judge Hand's words in context, "completely compensatory" and "most indubitable equivalence" seem only to mean that the creditor is entitled to his money or property. This might mean that if the creditor cannot obtain his money, then he should have his property returned, unless he can be provided with something of an undeniably equivalent value. But the value he receives need not be any more than the constitutional minimum—liquidation value. Another way to express the same idea is in terms of the creditor's allowed secured claim—to the extent of the value of the collateral.

When one considers the actual import of the bankruptcy court's quoted words in *Paradise Boat Leasing Corp.*, one may reasonably conclude that

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142. *Id.* at 942.

143. Bamerical Mortgage & Fin. Co. v. Paradise Boat Leasing Corp., 2 Bankr. 482, 1 COLLIER BANKR. CAS. 2d (MB) 413 (Bankr. D.V.I. Dec. 18, 1979).

144. *See* text accompanying notes 158–64 *infra.*

145. 2 Bankr. 482, 484–85, 1 COLLIER BANKR. CAS. 2d (MB) 413, 417 (Bankr. D.V.I. Dec. 18, 1979).

146. *Id.*

they simply provide for the constitutional minimum as well. If the creditor has a secured claim only to the extent of his collateral and there are no payments forthcoming to compensate for depreciation, no insurance to safeguard the collateral itself, and no other property to provide the creditor with a substitute lien, then it seems that the creditor *should* receive his property. On appeal to the district court,[147] however, the district judge did not agree with that proposition. The judge pointed out that termination of the stay was not the only method of relief and that a less drastic remedy should be fashioned on remand. Although these instructions were in more permissive terms, the clear meaning of the district court's decision was that the bankruptcy court had misconstrued the test when it required the "*most* indubitable equivalent" rather than the "*mere* indubitable equivalent" that the district judge said was required by the Code.[148]

If "mere indubitable equivalent" means *less* than the liquidation value of the property, then the district court's error is clear. Use of that expression indicates misunderstanding of the standard. The Reform Act's compensation to secured creditors sets a *minimum* of the forced-sale value of collateral. The creditor may be accorded more that the minimum. An interpretation of "indubitable equivalent" that allows something less than the liquidation value is erroneous.

In the presence of an equity cushion or a going concern, the Code provides the creditor with more than the constitutional minimum. In *Vlahos v. Pitts*[149] the court spoke of the equities on the creditor's side, observing that the existence of an equity cushion is a fundamental part of the original transaction with the debtor.[150] Although the court pointed out that the secured creditor assumes a risk that at the time of a default by the debtor the market for the collateral may be depressed and a sale not produce sufficient funds to pay the claim, it concluded:

> [T]o deprive the secured creditor of the right to proceed with foreclosure at a time when a cushion exists and to compel postponement of his remedy in the face of a clearly foreseeable possibility that the cushion may disappear, is to expose the secured creditor to risks which were not part of the bargain.[151]

The court went on to say that in the presence of an equity cushion, the secured creditor is entitled to the principal, interest, and other permissible charges to the date of sale, plus the costs of foreclosure and sale.[152] All of these costs were part of the court's conception of the bargain that the secured

147. Bamerical Mortgage & Fin. Co. v. Paradise Boat Leasing Corp., 5 Bankr. 822, 2 COLLIER BANKR. CAS. 2d (MB) 1153 (D.V.I. July 21, 1980).

148. *Id.* at 825, 2 COLLIER BANKR. CAS. 2d (MB) at 1158.

149. (*In re* Pitts), 2 Bankr. 476, 1 COLLIER BANKR. CAS. 2d (MB) 241 (Bankr. C.D. Cal. Dec. 21, 1979).

150. *Id.* at 477–78, 1 COLLIER BANKR. CAS. 2d (MB) at 242.

151. *Id.*

152. *Id.* Without an equity cushion, a creditor is entitled to no interest or other costs. Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 10 Bankr. 711, 712–13, 4 COLLIER BANKR. CAS. 2d (MB) 642, 644 (Bankr. C.D. Cal. Apr. 23, 1981).

creditor strikes with the debtor, even though it found no authority for the assessment of these costs, other than section 361(d)(2).

There is authority to be found in the Code for the allowance of these costs. Although the amount of the secured creditor's claim is to be determined as of the date of the commencement of the debtor's case,[153] and a claim for interest maturing after that date is disallowed,[154] section 506(b) provides that if an allowed secured claim is less than the value of the collateral, the holder of the secured claim will be allowed interest "and any reasonable fees, costs, or charges provided under the agreement."[155] Section 506(c) allows the trustee to "recover from property securing an allowed secured claim the reasonable . . . costs . . . of disposing of . . . such property to the extent of any benefit to the holder of such claim."[156] The legislative history of section 506(c)[157] indicates that it applies only when there is an equity cushion. If the creditor were to incur the expenses of disposing of the property, it seems reasonable that the creditor should be allowed these expenses as part of his claim. The *Pitts* court, then, reasoned correctly even though it did not cite the authority in section 506.

The third method by which a debtor may provide adequate protection to the creditor is by providing him with an additional or replacement lien on other property to compensate the creditor for depreciation or consumption of the property in which the creditor holds a security interest.[158] This method is particularly well suited to inventory and accounts receivable, which are unstable because of their turnover in a business. A creditor could be granted a replacement lien in post-petition accounts receivable to compensate the creditor for the reduction of receivables that occurs in a rehabilitating business. Despite the instability of these assets, a creditor who is grossly over-secured will not be granted a security interest in post-petition receivables. In *Anderson-Walker Industries v. SBA*[159] the SBA held security interests in the accounts receivable, machinery, fixtures, equipment, office furniture, and inventory of the debtor. The balance due on the loan was $67,500, the liquidation value of the collateral, $498,000. The SBA sought a security interest in post-petition accounts receivable, but the court ruled that the debtor would be allowed to use *pre*-petition accounts receivable as long as monthly payments of $2200 were maintained. The debtor needed these receivables to operate its business.[160]

153. 11 U.S.C. § 502(b).
154. *Id.* § 502(b)(2).
155. *Id.* § 506(b).
156. *Id.* § 506(c).
157. S. REP. NO. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5854, *and in* 16 BANKRUPTCY REFORM ACT OF 1978: A LEGISLATIVE HISTORY, at Doc. 52 (1979).
158. 11 U.S.C. § 361(2) (Supp. III 1979).
159. 3 Bankr. 551, 1 COLLIER BANKR. CAS. 2d (MB) 831 (Bankr. C.D. Cal. Apr. 14, 1980).
160. *Id.* at 552–53, 1 COLLIER BANKR. CAS. 2d (MB) at 833.

In *Crocker National Bank v. Kenny Kar Leasing, Inc.*[161] the debtor offered a guarantor, or backer, as a replacement lien so that it could use cash collateral that secured a loan to operate the business. The court observed that the guarantor would not be the equivalent of the security interest in the case collateral, because in the event of the debtor's default, the creditor would be required to commence suit and execute on the guarantor's assets. The guarantor had not offered a security interest to the creditor.[162]

There are many instances in which an additional lien cannot be offered to a creditor, because assets of debtors in rehabilitation proceedings are generally encumbered to the limit. The debtor in *Hawaii National Bank v. Hawaii Pacific Package Store, Inc.*[163] was in such a position. The bank possessed security interests in equipment, inventory, and accounts. The debtor requested time to build his business, but the court observed that the debtor offered no periodic payment or additional lien because it was encumbered to the limit. Lack of adequate protection caused the court to lift the stay.[164]

Since the three enumerated methods of adequate protection in section 361 are not exclusive, an imaginative debtor may find other ways to provide protection to his creditor. In the case of accounts receivable, for example, a portion can be sold to a third party and the proceeds applied to the debt in such a fashion that the debt is reduced by an equivalent percentage. It is also possible to protect the creditor by setting aside certain accounts or providing financial statements.[165]

Adequate protection may be provided in some instances by casualty insurance on the collateral. In *GMAC v. Ryals*[166] the debtor had made timely payments on an automobile at a reduced rate under his Chapter 13 plan. The court ruled that the stay should be continued on the condition that the debtor obtain insurance on the vehicle. The insurance and the payments would provide adequate protection to the creditor.[167]

As has been demonstrated, the existence of an equity cushion alone can provide adequate protection to the creditor,[168] especially when the property is

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161. (*In re* Kenny Kar Leasing, Inc.), 5 Bankr. 304, 2 COLLIER BANKR. CAS. 2d (MB) 767 (Bankr. C.D. Cal. July 23, 1980).

162. *Id.* at 305–06, 2 COLLIER BANKR. CAS. 2d (MB) at 769.

163. (*In re* Hawaii Pac. Package Store, Inc.), 4 Bankr. 502 1 COLLIER BANKR. CAS. 2d (MB) 746 (Bankr. D. Hawaii Apr. 3, 1980).

164. *Id.* at 504–05, 1 COLLIER BANKR. CAS. 2d (MB) at 749.

165. *See In re* Aurora Cord & Cable Co., 2 Bankr. 342, 347–48, 5 BANKR. CT. DEC. (CRR) 1310, 1313 (Bankr. N.D. Ill. Jan. 23, 1980); *see also* CIT Corp. v. Prime, Inc. (*In re* Prime, Inc.), 15 Bankr. 216, 219–20, 5 COLLIER BANKR. CAS. 2d (MB) 589, 593–94 (Bankr. W.D. Mo. Nov. 12, 1981) (court places conditions on continued use of collateral).

166. (*In re* Ryals), 3 Bankr. 522, 1 COLLIER BANKR. CAS. 2d (MB) 836 (Bankr. E.D. Tenn. Apr. 8, 1980).

167. *Id.* at 524, 1 COLLIER BANKR. CAS. 2d (MB) at 839. *See also* Commonwealth of Pa. St. Employees' Retirement Fund v. Roane (*In re* Roane), 8 Bankr. 997, 1000, 3 COLLIER BANKR. CAS. 2d (MB) 747, 751 (Bankr. E.D. Pa. Feb. 20, 1981) (FHA mortgage insurance).

168. *See, e.g.*, Caracciolo v. Spilsbury (*In re* Spilsbury), 5 Bankr. 578, 582, 2 COLLIER BANKR. CAS. 2d (MB) 925, 930 (Bankr. D. Nev. Aug. 6, 1980) (thin equity in property, but necessary to an effective reorganization); *In re* Pannell, 12 Bankr. 51, 54, 4 COLLIER BANKR. CAS. 2d (MB) 866, 870 (Bankr. E.D. Pa. June 15, 1981). *But see In re* Beaucrest Realty Assoc., 4 Bankr. 166, 168, 1 COLLIER BANKR. CAS. 2d (MB) 1095, 1097

appreciating sufficiently to offset the accrual of interest.[169] The degree of equity is determined by the value that the court places on the property. In most cases the parties offer appraisals[170] to the court, and in balancing the appraisals to arrive at a valuation, for example, of a business concern, the court considers elements such as the condition of the economy in the local area, the quality of the management of the business, the sources of capital necessary for the production of income, and the resiliency of the business to weather business cycles.[171]

In balancing the appraisals offered by the parties, the court must also consider the approach to valuation employed in the appraisal. For example, in *City National Bank v. San Clemente Estates*[172] two approaches for valuation were offered to the court. The property in question was land held for development by division into lots for the construction of single-family homes and condominium units. One approach was the "development" or "land residual" method. Under this method, the sales value of the lots is calculated and then the costs of development and sales plus a reasonable profit are deducted to reach the value of the land in its present state.[173] The other approach offered was the residual method taking inflation into account.[174] Because the court reasoned that inflation would result in higher prices for the lots, it disregarded the second method. The court noted that if the property were to revert to raw land and remain undeveloped, the residual method could not be used. The bulk-sale approach, which would result in a much lower value, would be employed in that event.[175]

Once a value has been placed on the property, the court will decide the degree of equity required to provide adequate protection. One court held that there must be an equity cushion of between forty and fifty percent when the property is land held for development.[176] Another held that a thirty-three percent cushion on such land was more than sufficient.[177] Each court took into account the economic conditions of the area, the first court finding un-

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(Bankr. E.D.N.Y. May 5, 1980) (requirement that the debtor have equity in the property does not apply when the business of debtor is managing or leasing of real property).

169. Pagni v. Pleasant Valley, Inc. (*In re* Pleasant Valley, Inc.), 6 Bankr. 13, 17, 2 COLLIER BANKR. CAS. 2d (MB) 325, 330 (Bankr. D. Nev. May 19, 1980).

170. Sometimes courts will accept the debtor's own inexpert testimony on the value of his house for the preliminary valuation if unrebutted by expert testimony presented by the mortgagee. *In re* Roane, 8 Bankr. 997, 1000, 3 COLLIER BANKR. CAS. 2d (MB) 747, 750 (Bankr. E.D. Pa. Feb. 20, 1981).

171. Caracciolo v. Spilsbury (*In re* Spilsbury), 5 Bankr. 578, 582, 2 COLLIER BANKR. CAS. 2d 925, 930 (Bankr. D. Nev. Aug. 6, 1980). *See also In re* High Sky, Inc., 15 Bankr. 332, 336–37, 4 COLLIER BANKR. CAS. 2d (MB) 1290, 1294–96 (Bankr. M.D. Pa. Aug. 4, 1981).

172. (*In re* San Clemente Estates), 5 Bankr. 605, 2 COLLIER BANKR. CAS. 2d (MB) 1003 (Bankr. S.D. Cal. Aug. 11, 1980).

173. *Id.* at 607–08, 2 COLLIER BANKR. CAS. 2d (MB) at 1006–07.

174. *Id.* at 608, 2 COLLIER BANKR. CAS. 2d (MB) at 1008.

175. *Id.*

176. Diversified Mortgage Investors v. Lake Tahoe Land Co., 5 Bankr. 34, 37, 1 COLLIER BANKR. CAS. 2d (MB) 1033, 1038 (Bankr. D. Nev. Apr. 24, 1980).

177. City Nat'l Bank v. San Clemente Estates (*In re* San Clemente Estates), 5 Bankr. 605, 610, 2 COLLIER BANKR. CAS. 2d (MB) 1003, 1010 (Bankr. S.D. Cal. Aug. 11, 1980).

certain economic conditions, the second finding the local area to be expanding and prosperous.

In other cases, 17.4 percent of the fair market value of commercial real property was adequate,[178] and 15.3 percent of the market value for residential property was sufficient.[179] In *In re Tucker*[180] a cushion of 7.4 percent on residential real property was held insufficient protection, and in *In re Roane*[181] an equity cushion on residential property of 33 percent was sufficient. Given the proper conditions, the presence of a substantial equity cushion can be convincing evidence of adequate protection to the secured creditor.

IV. CONCLUSION

Termination of stay litigation arises most often in rehabilitation proceedings.[182] Because the rehabilitation of a debtor may require an extended amount of time, there is more risk to a secured crditor's collateral than is present in a liquidation proceeding. In addition to the enumerated methods of adequate protection in section 361—periodic cash payments,[183] additional or replacement liens,[184] and the indubitable equivalent of the creditor's interest in the collateral[185]—the debtor can provide the secured creditor with protection by the presence of an equity cushion, insurance on the collateral, and financial statements.[186] If the debtor does not provide concrete proposals for the protection of the creditor's interest, the bankruptcy court will lift the stay on the collateral and allow the secured creditor to commence proceedings in aid of execution against the property under state law. If the debtor can provide concrete proposals to adequately protect the creditor, the policies of the Code require continuance of the stay. Although the provisions of the Code are designed to protect the debtor during this rehabilitation period, the Code is likewise intended to insure that the creditor receives the benefit of his original bargain with the debtor.

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178. Heritage Sav. & Loan v. Rogers Dev. Corp. (*In re* Rogers Dev. Corp.), 2 Bankr. 679, 685, 1 COLLIER BANKR. CAS. 2d (MB) 499, 507 (Bankr. E.D. Va. Feb. 14, 1980) ($130,000 (equity cushion) ÷ $750,000 (value of collateral)).

179. *In re* Pitts, 2 Bankr. 476, 477–78, 1 COLLIER BANKR. CAS. 2d (MB) 241, 243 (Bankr. C.D. Cal. Dec. 21, 1979) ($19,125 (equity cushion) ÷ $125,000 (value of collateral) = 0.153).

180. (Sanders v. Tucker), 5 Bankr. 180, 183–84, 2 COLLIER BANKR. CAS. 2d (MB) 535, 540 (Bankr. S.D.N.Y. July 2, 1980).

181. 8 Bankr. 997, 999–1000, 3 COLLIER BANKR. CAS. 2d (MB) 747, 750 (Bankr. E.D. Pa. Feb. 20, 1981) ($7500 (equity cushion) ÷ $23,000 (collateral value) = 0.33).

182. *See* text accompanying notes 104–24 *supra*.

183. *See* text accompanying notes 128–37 *supra*.

184. *See* text accompanying notes 158–64 *supra*.

185. *See* text accompanying notes 138–57 *supra*.

186. *See* text accompanying notes 164–75 *supra*.